# City of Memphis, Tennessee

# Debt Policy

# &

# Procedures Manual


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**January 1, 2006**

# Introduction

The Debt Management Policy formally creates a solution to managing debt effectively and efficiently. It establishes parameters for issuing debt and managing a debt portfolio which encompasses the City's specific capital improvement needs, its ability to repay financial obligations, and the existing legal, economic, financial and debt market conditions. This framework allows us to make informed borrowing decisions. The items outline in the Debt Management Policy are not goals or a list of rules to be applied toward the City's debt issuance, rather these policies should be utilized as tools to ensure that adequate financial resources are available to support the City's long-term capital needs.

The Debt Management Policy is located on the Intranet and the Internet (www.CityofMemphis.org) for the City of Memphis. This medium makes the Debt Management Policy user friendly by providing guidelines for prudent fiscal operational practices. The Debt Management Policy was approved by Executive Management and the Mayor, and formally adopted via resolution by the City Council on February 19, 2002.

The policy details Capital Planning and Financing, Structured Approach to Debt Management, Financial Consultants and Service Providers, Method of Sale, Short-Term Debt and Interim Financing, Credit Ratings and Enhancements, Refunding of City Indebtedness and Market and Inter-Agency Relationships.

The cost/benefit analysis of the Debt Management Policy has had a positive impact on the City of Memphis. It is a major plus when rating agencies determine that such a plan is in place that set forth parameters and guidelines for prudent management. The return on investment is clearly shown by the high grade, high quality bonds rated by 3 major rating agencies. Also, this policy allows the City of Memphis to maintain maximum favorable positions by using key debt ratios.

Questions regarding information in this Debt Policy should be directed to Ms. Sheila Whalum, Deputy Director of Finance, City of Memphis, Room 368, 125 North Main Street, Memphis, Tennessee 38103, telephone (901/576-6184).

# City of Memphis, Tennessee

# Debt Management
# Policies and Procedures Manual

## PURPOSE

The purpose of the Debt Management Policies and Procedures is to set forth parameters and guidelines for prudent, fiscal operational practices and management related to the City of Memphis debt issuances and Debt Portfolio. The Debt Management Policies and Procedures were developed by the City's Finance Division, approved by executive management and the Mayor, and formally adopted via resolution, by the Memphis City Council.

## DEBT MANAGEMENT POLICY ADOPTION
**February 19, 2002**

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# *HISTORY OF CITY OF MEMPHIS BONDS*

For all bond issues prior to July 1, 1993, the City issued “Bearer” Bonds whereby the City printed both principal certificates and coupon stubs requiring the holder of the bond to present the coupons and bonds to the paying agent for payment. For bond issues after July 1983, and before February 1987, the City issued Registered Bonds requiring the City to print principal certificates only. These bonds could be registered with broker/dealers allowing interest payments to be credited directly to the owners account. Effective February 1987, The City began issuing debt in “Book-Entry” form. This does not require the printing of bonds but requires registration with an agent such as the Depository Trust Company. “Book-Entry” has proven to be more cost efficient than printing bonds and had no adverse effect on bond buyers desires to own City of Memphis debt.

The enactment of the 1986 Tax Reform Act had a major impact on how the City handles its debt. According to the Act, the City is required to rebate to the federal government any earnings on bond proceeds in excess of the arbitrage yield on the Bonds. The Regulations provide issuers with a few exceptions to the arbitrage rebate requirement. In order to effectively calculate and manage the adherence to the complex regulations governing tax-exempt debt, the City has a contract with a firm who specializes in arbitrage calculations that calculates the annual excess arbitrage amount that is to be treated as a liability until time of payment to the U.S. Treasury. The Firm also certifies the annual calculations and prepares the appropriate U.S. Treasury forms which accompany the payment of excess arbitrage at five and ten year intervals. The first payment was made in 1992 for the 1987 bond issue.

It is the City’s objective to maximize interest earnings related to the investment of cash proceeds from bond sales to:

a. Reduce our exposure to negative arbitrage
b. Adhere to rules and regulations dictated by the U. S. Government

## *CURRENT DEBT PORTFOLIO POLICY*

The City of Memphis will provide a copy of its comprehensive financial report upon request and will disseminate other information that it deems pertinent to the market in a timely manner.

The City of Memphis recognizes a long-term commitment to full exposure of the practices for issuing debt and managing the debt portfolio by the Debt Management Office. The sustained growth of Memphis has required the City to rely on the issuance of bonds, as a major source of financing for its capital improvement programs. Since 1957, the City has been issuing general obligation debt. The following represents the various types of debt the City maintains:

**General Obligation Bonds-City -** Otherwise considered Debt Issued Without Other Revenue Support; these bonds represent the true financial liability of the City. Bond proceeds are used for numerous capital improvement projects such as roads, streets, bridges, land, buildings and large tangible personal property.

**General Obligation Bonds-Sewer Fund** - The Sewer Fund issues its own Revenue Bonds. The debt is considered self-supporting; however, the City is contingently liable.

**General Obligation Bonds-Board of Education** - These bonds represent funds used for the acquisition of land, construction of buildings and general improvements to City operated schools. This debt is considered self-supporting since the Memphis School Board reimburses the City for payment of principal and interest made on the School Board's behalf. The City is contingently liable for this debt; however, the City levies taxes on behalf of the Board of Education to cover its debt service payments.

**General Obligation Bonds-Airport Authority** - The Memphis and Shelby County Airport Authority was formed in 1969. The City has the ability to issue debt on behalf of the Authority if both parties believe it is in the best interest of the City and the Authority to do so.

**State Loans City Sewer Fund** - Represents low interest loans made to the City by the State of Tennessee to fund certain Sewer System improvements. The City's good faith and taxing ability was pledged to this loan; however, the fund makes all principal and interest payments for itself.

**Capital Outlay Notes** - The City has the authority to issue Capital Outlay Notes for such items as vehicles or equipment and matches the maturity of the notes with the life of the asset. These are considered short-term.

**Capital Lease Obligations** - Capital lease allows the City the choice to finance vehicles and/or equipment at the lowest cost. Either Notes or Leases can be used for the same purposes. These are considered short-term.

**Commercial Paper** - The City has the authority and ability to take advantage of short-term yields by the use of Commercial Paper. The life of such paper does not exceed 270 days. These are considered short-term.
**Federal or State Government Loans** - Loans used for Board of Education capital purposes.

**Variable Rate Debt** - From time to time, the municipal financial markets make it attractive for municipal bond issuers to issue debt in the form of variable rate. These rates, for such debt, can be set weekly, monthly, quarterly or yearly. For the City of Memphis purposes, Variable Rate debt should not exceed 25 % of principal debt portfolio. As yield curves tend to invert, or long-term fixed rated tend to decrease, it may be in the City's best interest to convert the City's variable rate debt to fixed rates.

## *GOALS AND OBJECTIVES*

The Debt Management Policy formally establishes parameters for issuing debt and managing a debt portfolio which encompasses the City's specific capital improvement needs, its ability to repay financial obligations, and the existing legal, economic, financial and debt market conditions. The policies outlined in the Debt Management Policy are not goals or a list of rules to be applied toward the City's debt issuance, rather these policies should be utilized as tools to ensure that adequate financial resources are available to support the City's long-term capital needs. Specifically, the policies outlined in this document are intended to assist the City in the following.

**A**. Moderate the issuance of debt through parameters such as legally authorized debt limits and tax or expenditure ceilings, including coverage requirements imposed by bond covenants. The City's debt affordability is determined by many factors including the economic and demographic trends in the community and outstanding debt levels. It is also affected by the outstanding and planned debt of other governments in a community relying on the same tax base. Overlapping debt levels are integral to an affordability assessment.

- **B.** Minimize the use of property tax revenues as a funding source for debt service.
- **C.** Devise debt service structures that are equal to or less than the estimated useful life of the asset requiring the funding.
- **D.** Protect and enhance the City's credit rating.
- **E.** Limit use of debt proceeds only for purposes outlined in the Local Government Public Obligations Act of 1986; Title 9, Chapter 21 of the Tennessee Code Annotated see page 28.
- **F.** If outside consultants or vendors are required, hire such professionals that will help to maximize the effort associated with the issuance of debt and minimize the cost.
- **G.** Assist related entities of the City in issuing debt, if needs warrant.
- **H.** Minimize the overall cost of debt issuance.
- **I.** Maximize investment earnings allowable under the Tax Reform Act of 1986.
- **J.** Maintain a contingency plan in case of funding short-falls (i.e., Reserve Fund, the City should maintain General Fund (GF)Undesignated Reserves in excess of 10% of GF expenditures)
- **K.** Prevent reliance on nonrecurring revenue items.
- **L.** Maintain maximum favorable position verses key debt ratios, as follows:

| **Key Debt Ratios Description / Trend** | **City of Memphis FY 2006 Debt Ratios** |
|---|---|
| **Net Debt to Appraised Property Value %** (Favorable Trend = Lower than 3.0%) | 2.82 % |
| **Per Capital Debt to Per Capital Personal Income %** (Favorable Trend = 3% - 6%) | 2.95% |
| **% of Principal Debt Retired in Ten Years** (Favorable Trend = Greater than 55%) | 57.6% |

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## *CAPITAL PLANNING AND FINANCING POLICY*

Each year the City of Memphis will adopt a Capital Improvement Plan for five years.

**A. <u>Capital Planning and Financing System.</u>** The City has developed a capital planning and financing system to be used in preparing a multi-year Capital Improvement Plan for consideration and adoption by the City Council as part of the City's budget process. Individual divisions and agencies will prepare a multi-year capital plan. The coordination and preparation of the City-wide Capital Improvement Plan will reside with the Finance Division. This Plan anticipates the City's capital funding needs for the coming five fiscal years to be updated periodically or at least annually. The Plan contains a comprehensive description of the sources of funds and the timing of capital projects for <u>future operating and capital</u> <u>budgets</u>, effect of the projects on future debt sales, debt outstanding, debt service requirements, the impact on future debt burden, and current revenue requirements. In this latter regard, the Plan analyzes the conformance of the planned financings with policy targets regarding the (1) magnitude and composition of the City's indebtedness, and (2) the economic and fiscal resources of the City to bear such indebtedness over the next five years. Affordability impacts of the Plan will be evaluated in consultation with the various City Divisions.

In managing its Debt, the City of Memphis, as it relates to debt issuance is to provide the most efficient and economical method of funding of capital improvement projects while minimizing the out-of-pocket costs to the City. This is accomplished in several different ways:

- Awareness of the existing outstanding debt balance and the resulting impact on the tax rate applicable to the debt service fund.

- Maximization of revenue sources other than general property taxes to fund capital improvement projects. These revenues will include but not be limited to:

    - Sewer Fees
    - Hotel-Motel Tax
    - Intergovernmental Revenue
    - Municipal State Aid
    - Local Shared State Tax
    - Excess fund balance reserves
    - Other General Government Non-Tax Revenues

- Take advantage of structuring alternatives and market conditions to issue debt that will minimize the true interest cost of the debt.

A sound debt management program begins with a well-devised capital plan provided by analyzing the changing revenue situation to maximize the City's opportunity of such revenues and minimize property taxes. Therefore, a multi-year Capital Improvement_Plan, which integrates pay-as-you-go financing and the projects to be financed, is critical.

In addition to capital project costs, the Capital Improvement Plan considers and includes the following elements:

1. Qualified capital projects
2. Description of all sources of funds
3. Availability of current revenues (non-debt sources) which are reflected in the City's multi-year forecast (Pay-as-you-go financing)
4. Timing of capital projects
5. A financing plan or methodology and debt service requirements
6. Multi-year operational Budget Impact vs. Capital Plan
7. Monthly Appropriation (Financial) Report

**B. Debt Calendar and Financing Priorities.** The responsibility of the Deputy Director of Finance within the context of the Capital Improvement Plan, to oversee and coordinate the timing, process of issuance, and marketing of the City's borrowing and capital funding activities required in support of the Plan. In this capacity, the Deputy Director of Finance shall make recommendations to the Finance Director regarding necessary and desirable actions and shall keep him/her informed through regular and special reports as to the progress and results of current-year activities under the Plan.

**C. Capital Outlay Notes.** The City has the authority to issue Capital Outlay Notes for assets with relative short lives such items as vehicles or equipment. The City shall seek to fund short-term assets from current revenue resources depending upon the specific projects and annual budgetary constraints. Capital Outlay Notes will not exceed 5 years.

**D. Pay-As-You-Go Funding.** As part of its capital financing philosophy, if economically feasible, the City may make direct General Fund contributions not to exceed 5% of its current revenues.

**E. Debt Authorization.** No City debt issued for purpose of funding capital projects shall be authorized by the City Council unless it has been included in the Capital Improvement Plan or until the Council has modified the Plan. Such modification shall occur only after the Council has received a report of the impact of the contemplated borrowing on the existing Capital Improvement Plan and recommendations as to the financing arrangements from the Deputy Director of Finance and the Finance Director.

## *STRUCTURAL APPROACH TO DEBT MANAGEMENT POLICY*

The City shall conduct its finances so that the amount of general obligation ("GO") debt outstanding does not exceed 12% of the City's taxable assessed valuation.

**A. Debt Affordability Targets:** The ratios, standards, and limits identified are primarily intended to restrict the use of debt financing in order to facilitate long-term access to capital while ensuring that financial leveraging decisions do not negatively impact the City's annual operations and credit rating.

1. Self-Supporting Debt**.** The City may sponsor conduit financing for those activities (i.e. economic development, housing, health facilities, etc.) that have a general public purpose and are consistent with the City's overall service and policy objectives as determined by the City Council. All conduit financings must insulate the City completely from any credit risk or exposure and must first be approved by the Finance Director before being submitted to City Council for authorization and implementation. From time to time, the City will issue debt for which there is an identified repayment source. For debt to be characterized as self-supporting, the repayment source must support the issue through its maturity.

2. Overlapping Debt. Debt from all other jurisdictions, which impact City taxpayers, will be taken into consideration in planning debt issuance.

**B. Target Limitations on Lease-Purchase Financing of Equipment and Furnishings.** The City may enter into short-term lease-purchase obligations to finance the acquisition of capital equipment and furnishings with estimated useful lives of less than ten years. Outstanding lease-purchase obligations issued to finance capital equipment and furnishings shall be evaluated in terms of the requesting division's ability to cover lease payments within its annual operating budget. Repayment of these lease-purchase obligations shall occur over a period not to exceed the useful life of the underlying asset or in any case no longer than five years from the dated date of such obligations. The Debt Management Office shall be responsible for developing procedures for use by City Divisions interested in participating in the lease-purchase program, and for setting repayment terms and amortization schedules, in consultation with the participating Divisions.

A capital lease allows the City the choice to finance vehicles and/or equipment at the lowest cost. Either Notes or Leases can be used for the same purposes. In compliance with GFOA Recommended Practices, the Finance Director is to have full knowledge of any lease agreements under taken by any Division. The Debt Management Office and Purchasing will handle all leasing and will submit one

Request for Proposals annually to obtain a leasing agent. The company selected will handle all lease requests for that year.

Each Division or Agency should include all capital lease requirement(s) within the relevant fiscal year's operating budget as an annual appropriation. For assistance, each division should meet with the Deputy Director of Finance. For each fiscal year, during the month of October, all Divisions should let the Deputy Director of Finance know in writing its intent to execute the budgeted Lease Purchase for that fiscal year.

A. **Limitations on General Fund Loan Guarantees and Credit Support.** As part of City's financing activities, General Fund resources may be used to provide credit support of loan guarantees for public or private developments that meet high priority City needs. Before such General Fund commitments are made, specific policy goals and objectives that determine the nature and type of projects qualifying for such support, and specific limitations to be placed on the maximum amount of General Fund resources pledged to such projects shall be developed. The Finance Division shall be responsible for coordinating the development of such policies and goals, which shall not take effect until approved by the City Council. Key factors that will be considered in determining whether or not the General Fund should be used to secure a particular debt obligation will include the following:

1. Demonstration of underlying self-support, thus limiting potential General Fund financial exposure.
2. Use of General Fund support as a transition to a fully stand alone credit structure, where interim use of General Fund credit support reduces borrowing costs and provide a credit history for new or hard to establish credits.
3. General Fund support is determined by the Finance Director to be in the City's overall best interest.

B. **Target Limitations on the Issuance of Revenue-Secured Debt Obligations.** The City shall seek to finance the capital needs of its revenue producing enterprise activities through the issuance of revenue-secured debt obligations. Prior to issuing revenue-secured debt obligations, City Divisions, in consultation with the Deputy Director of Finance will develop financial plans and projections showing the feasibility of the planned financing, required rates and charges needed to support the planned financing, and the impact of the planned financing on ratepayers, property owners, City Divisions, and other affected parties. The amount of revenue-secured debt obligations issued by a City Division will be limited by the economic feasibility of the overall financing plan as determined by the Deputy Director of Finance.

Revenue-secured debt obligations must first be reviewed and approved by the Deputy Director of Finance and the Finance Director before being issued.

E. **Rapidity of Long-Term Debt Repayment.** Generally, borrowings by the City should be of a duration that does not exceed the economic life of the improvement that it finances and where feasible should be shorter than the projected economic life.

Moreover, to the extent possible, the City should design the repayment of debt so as to recapture rapidly its credit capacity for future use. The City shall strive to repay the principal amount of its long-term general obligation by at least 55% or greater within ten years. The City may choose to structure debt repayment so as to wrap around existing obligations or to achieve other financial planning goals. Such alternative structures shall be subject to the approval of the Deputy Director of Finance and the Finance Director.

**F.** **Use of Variable-Rate Securities.** When appropriate, the City may choose to issue securities that pay a rate of interest that varies according to a pre-determined formula or results from a periodic remarketing of the securities. The decisions to issue such securities must be reviewed and approved by the Deputy Director of Finance and the Finance Director before Council is requested to approve their issuance.

**G.** **Pledge of Restricted Funds to Secure Debt.** The City has the power to make an irrevocable pledge of a security interest in an account created exclusively for the security of holders of City obligations. Before such funds are used to secure a prospective financing, policies regarding the use of such restricted funds shall be developed by the affected Division and the Deputy Director of Finance subject to approval by the Finance Director, to ensure that the use of such funds to secure bonds does not violate restrictions on such funds and that underlying program commitments can be maintained in addition to meeting debt service obligations on debt secured by the restricted funds. These policies shall be presented as recommendations to Council prior to or at the time issuance of the secured debt is to be authorized.

## *FINANCIAL CONSULTANTS AND SERVICE PROVIDERS POLICY*

All professional service providers will be chosen by the Director of Finance and the Deputy Director of Finance.

The City's Debt Management Office shall be responsible for establishing a solicitation and selection process for securing professional services that are required to develop and implement the City's debt program. Goals of the solicitation and selection process shall include encouraging participation from qualified service providers, both local and national, and minority owned firms, at competitive prices.

The City also expects that its financial advisor(s) will provide the City with objective advice and analysis, maintain the confidentiality of City financial plans, and be free from any *conflicts of interest*.

All financing team members will be required to provide full and complete disclosure, relative to agreements with other financing team members and outside parties. The extent of disclosure may vary depending on the nature of the transaction. However, in general terms, no agreements shall be permitted which could compromise the firm's ability to provide the highest quality level of independent advice or service which is solely in the City's best interests or which could reasonably be perceived as a *conflict of interest*.

**A. Financial Advisor.** The Deputy Director of Finance shall make recommendations to the Finance Director regarding the selection of financial advisors to be employed and the duration of such employment. The solicitation and selection process for such services will seek to obtain the highest quality level of Professional, Technical, and Expert Services. The time period for employment may relate to an individual or a series of financings, or for a specified period of time.

The City may employ the services of a financial advisor to aid in the following:

(1) To perform all the duties customarily performed by financial consultants in connection with the public offering of municipal securities.
(2) To proceed immediately with investigation, studies and planning for the purpose of formulating a sound plan of financing by structuring the right kind and size of deal that is in accordance with the authorization and desires of the City.
(3) In the case of a competitive sale, to prepare and distribute to prospective investors, financial institutions and bidders an Official Statement and the Official Notice of Sale, comprehensive information with respect to any notes or bonds being offered by the City, the legal documents and other necessary information.

(4) In the case of a negotiated sale, to assist the City in the preparation and distribution of the Official Statement for any Notes or Bonds being offered by the City, the legal documents and other necessary information.
(5) To assist the bond counsel.
(6) To assist with the adoption of all resolutions, the publishing of all legal notices and any other matter required for the successful sale and delivery of the Bonds.
(7) To advise the City on market conditions and other factors affecting the successful sale of the Bonds.
(8) To establish a wide interest in the Bonds or Notes among prospective bond underwriters and investors.
(9) To confer with Moody's Investors Service, Inc. Standard & Poor's Corporation, Fitch and/or any other rating service to provide them with complete information regarding the City so that they may properly evaluate the quality of the proposed Bonds and Notes.
(10) To recommend either a competitive or negotiated sale of the debt. If the debt is to be sold at competitive sale, the Financial Advisor will coordinate the public sale of such securities through a competitive bid process either in person or via Internet. If the debt is to be sold at a negotiated sale, the Financial Advisor along with the Finance Director and Deputy Director of Finance will recommend a managing underwriter to represent the City in all of its negotiations with the selected investment banker including the actual pricing of the debt.
(11) To assist in soliciting bids for and procuring the services of credit enhancement agencies, banking services and related financial services essential to any alternative forms of financing which the City may elect to use.
(12) On behalf of the City, arrange for the printing, signing and delivery of the securities and to arrange for the printing and delivery of Preliminary and Final Official Statements.
(13) To assist the City in connection with any bond election that might be required by law.
(14) To provide additional financial services to the City on an individual as needed basis, including but not limited to:

- Capital budgeting planning
- Investor relations activities
- Debt management policy
- Investment strategy and advice
- Project planning
- Expert testimony
- Advice on financial regulations

**B. <u>Bond Counsel.</u>** As part of its responsibility to oversee and coordinate the marketing of all City indebtedness, the Deputy Director of Finance shall make recommendations to the Finance Director regarding the selection of Bond Counsel to be employed and the duration of the employment for individual or a series of financings. The solicitation and selection process for such services will seek to obtain the highest-level quality of for Professional, Technical, and Expert Services. The Director shall make such selection, taking into consideration these recommendations.

The Bond Counsel will provide a written legal opinion affirming that the City is authorized to issue the proposed debt, that the City has met all constitution and statutory requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. The approving opinion and other documents relating to the issuance of debt will be prepared by Counsel with extensive experience in public finance and tax issues. Compensation will be based on a fixed fee schedule and will vary based on the complexity of the transaction. The City will deliver at its expense to bond purchasers the opinion of the City's bond counsel, that the bonds are valid and legally binding obligations of the City and that the City has the power and is obligated to levy ad valorem taxes for the payment of bonds and interest thereon on all taxable property in the City subject to taxation. Bond Counsel also provides appropriate opinions as to the tax-exempt status and compliance with applicable laws of each bond issue at the time of issuance.

**C. Underwriters.** The Deputy Director of Finance shall select providers of underwriting services for all debt issues through negotiated or private placement based on the firm's experience and capability. The solicitation process used for these services shall seek to obtain the highest level of quality for Professional, Technical, and Expert Services. In addition, the proposal solicitation and selection process for negotiated sales as developed by the Deputy Director of Finance and amended from time to time, shall also be followed. The selection of underwriters may be for an individual or series of financings or a specified time period. The Finance Director shall make such selections taking into consideration the recommendations of the Deputy Director of Finance.

*Senior Manager / Co-Manager*. The Deputy Director of Finance and the Finance Director shall have the right to select a senior manager and/or co-manager for a proposed negotiated sale. The criteria shall include but not be limited to the following:

A. The firm's ability and experience in managing complex transactions
B. Prior knowledge and experience with the City.
C. The firm's willingness to risk capital and demonstration of such risk
D. The firm's ability to sell bonds
E. Quality and experience of personnel assigned to the City's engagement
F. Financing plan presented

*Selling Groups.* The City may establish selling groups in certain transactions. To the extent that selling groups are used, the Director of Finance and the Deputy Director of Finance may make appointments to selling groups from within the pool of underwriters or from outside the pool, as the transaction dictates.

*Underwriter's Counsel.* The selection of the underwriter counsel by the lead underwriter shall be made in consultation with the Finance Director.

*Disclosure Counsel.* In any negotiated sale of City debt in which legal counsel is required to represent the City, in regards to tax compliance, the appointment will be made by the City.

**D. Paying Agent.** The Deputy Director of Finance shall solicit proposals periodically for paying (escrow) agent services from qualified commercial and trustee banks. The cost of providing such services shall be used by the Deputy Director of Finance along with other qualitative measurements, in recommending Paying Agents to the Finance Director, along with the terms of such agreement.

**E. Other Service Providers.** The Deputy Director of Finance shall periodically solicit for other service providers (escrow agents, verification agents, trustee, etc.). The cost of providing such services shall be used by the Deputy Director of Finance in developing a recommendation to the Finance Director, along with the terms of such agreement.

Other consultants or vendors may be called upon to provide various services such as:

- Certified Public Accountants - Verification of financial data
- Financial Institutions - Provide letter(s) of credit facilities for variable rate(s) issues
- Printers – To print Official Statements
- Feasibility Consultants – To review financial and operational feasibility of projects and conduct rate studies
- Arbitrage Specialists – To track rebate liability

## *METHOD OF SALE POLICY*

The City, as a matter of policy, shall seek to issue its new debt obligations in a competitive sale unless it is determined by the Deputy Director of Finance that such a sale method will not produce the best results for the City.

**A.** **Competitive Sale.** In such instances where the City in a competitive bidding for its debt securities (whether general obligation or non-general obligation debt) deems the bids received as unsatisfactory or does not receive bids, it may, at the election of the Finance Director, enter into negotiation for sale of the securities.

Generally, with a competitive sale, the City's bonds shall be awarded to the bidder providing the lowest true interest cost and best bid (lowest cost / best service) adhering to the requirements set forward in the official Notice of Sale.

**B.** **Negotiated Sale.** When determined appropriate by the Deputy Director of Finance and approved by the Finance Director, the City may elect to sell its debt obligations through a negotiated sale. Such determination may be made on an issue-by-issue basis, for a series of issues, or for part or all of a specific financing program. Selection of the underwriting team shall be made pursuant to selection procedures set forth in these Debt Policies.

Debt Refunding may be initiated by the Deputy Director of Finance as the market allows and are generally, negotiated.

*Underwriter's Discount* shall be as follows:

a) The Deputy Director of Finance will evaluate the proposed underwriter's discount against comparable issues in the market. If there are multiple underwriters in the transaction, the Deputy Director of Finance will determine the allocation of fees with respect to the management fee. The determination will be based upon participation in the structuring phase of the transaction.

b) All fees and allocation of the management fee will be determined prior to the sale date; a cap on management fee, expenses and underwriter's counsel will be established and communicated to all parties by the Deputy Director of Finance. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any additional expenses must be substantiated.

*Evaluation of Financing Team Performance.* The City will evaluate each bond sale after its completion to assess the following: costs of issuance including underwriters' compensation, pricing of the bonds in terms of overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credits. This evaluation will be maintained b the Debt Management Office.

*Designation Policies.* To encourage the pre-marketing efforts of each member of the underwriting team, orders for the City's bonds will be net designated, unless otherwise expressly stated. The City shall require the senior manager to:

a) Equitably allocate bonds to other managers and the selling group
b) Comply with Municipal Securities Rulemaking Board (MSRB) regulations governing the priority of orders and allocations
c) Within 10 working days after the sale date, submit to the Deputy Director of Finance a detail of orders, allocations and other relevant information pertaining to the City's sale.

*Issuance costs* associated with the issuance of debt will include but not be limited to the following:

(1) Underwriter's takedown (see Negotiated Sale)
(2) Underwriter's management fees (see Negotiated Sale)
(3) Underwriter's expenses (see Negotiated Sale)
(4) Financial advisor fees
(5) Bond counsel and other legal fees
(6) Printing fees
(7) Publication fees
(8) Paying Agent and trust fees
(9) Travel expenses
(10) Accountants fees
(11) Letter of Credit fees
(12) Bidding Agent fees
(13) Rating Agency fees
(14) Insurance Premiums
(15) Regulatory fees (Federal & State)

## *SHORT-TERM DEBT AND INTERIM FINANCING POLICY*

Where their use is judged by the Deputy Director of Finance to be prudent and advantageous to the City, the City has the power to enter into agreements with commercial banks or other financial entities for purposes of acquiring lines or letters of credit that shall provide the City with access to credit under terms and conditions as specified in such agreements.

**Lines and Letters of Credit.** Before entering into any such agreements, takeout financing for such lines or letters of credit must be planned for and determined to be feasible by the Deputy Director of Finance. Any agreements with financial institutions for the acquisition of lines or letters of credit shall be approved by the Finance Director. Lines and letters of credit entered into by the City shall be in support of projects contained in the approved Capital Improvement Plan.

*Letters of Credit* (LOC). The City shall have the authority to enter into a letter-of-credit agreement when such an agreement is deemed prudent and advantageous. The City's financial advisors shall prepare and distribute to qualified financial institutions a request for qualifications which includes terms and conditions that are acceptable to the City.

1. Provider Selection. Only those financial institutions with long-term ratings greater than or equal to that of the City, and short-term ratings of VMIG 1/A-1 F1, by Moody's Investors Service, Standard & Poor's and Fitch, respectively may be solicited.
2. Selection Criteria. The selection criteria for LOC provider will include a distribution of a request for qualifications which will include, but not limited to the following:

    a) Ratings at least equal to or better than the City's
    b) Evidence of ratings
    c) Trading value relative to other financial institutions
    d) Terms and conditions acceptable to the City; the City may provide a term sheet along with the request for qualifications to which the financial institution may make modifications
    e) Representative list of clients for whom the bank has provided liquidity facilities
    f) Fees, specifically, cost of LOC, draws, financial institution counsel and other administrative charges

**Bond Anticipation Notes.** Where their use is judged by the Deputy Director of Finance to be prudent and advantageous to the City, the City may choose to issue Bond Anticipation Notes as a source of interim construction financing. Before issuing such notes, takeout financing for such notes must be planned for and determined to be feasible by the Deputy Director of Finance Bond Anticipation Notes may be sold in either a competitive or negotiated sale, subject to approval by the Finance Director with recommendations to City Council for authorization.

**A. <u>Tax and Revenue Anticipation Notes.</u>** Where their use is judged by the Deputy Director of Finance to be prudent and advantageous to the City, the City may choose to issue Tax and Revenue Anticipation Notes to fund internal working capital cashflow needs. Before issuing such notes, cashflow projections will be prepared by the appropriate City Divisions and reviewed by the Deputy Director of Finance. Tax and Revenue Anticipation Notes may be sold in either a competitive or negotiated sale, subject to approval by the Finance Director with recommendations to City Council for authorization.

**B. <u>Commercial Paper.</u>** The City may choose to issue Commercial Paper as a source of interim construction financing for projects contained in the City's approved Capital Improvement Plan only after the Deputy Director of Finance in consultation with the Financial Advisor, determines that such a financing represents the least cost interim financing option for the City. Furthermore, Commercial Paper shall not be issued for City capital programs unless it is of sufficient economic size as determined by the Deputy Director of Finance. A report recommending the issuance of Commercial Paper must first be approved by the Finance Director, before recommendations are made to City Council authorizing the establishment of such a program.

# Swap Guidelines

# *DERIVATIVE PRODUCTS POLICY*

The City of Memphis may use derivative products to reduce risk exposures or reduce interest costs, but not be used for speculative purposes.

**Background**
State statutes direct the State Funding Board to establish guidelines, rules or regulations with respect to interest rate swap agreements, other interest rate hedging agreements and forward purchase agreements that may be entered into by certain local governmental entities. The State Funding Board adopted these guidelines on September 27, 2000, effective October 15, 2000; amended on July 30, 2002, effective August 1, 2002. State statutes require that if such a governmental entity intends to enter into such an agreement and submits such a request, the State Comptroller is required to determine whether the proposed agreement complies with the guidelines and to report thereon to the governmental entity. Furthermore, Swaps shall not be issued for City capital programs unless it is of sufficient economic size as determined by the Deputy Director of Finance. A report recommending the issuance of Swaps must first be approved by the Finance Director, before recommendations are made to City Council to authorize the establishment of such a program. The guidelines are set forth below. The Guidelines do not govern contracts or other investments agreements other than the Forward Purchase Authorizing Statutes or the Interest Rate Authorizing Statutes, whether or not they relate to the Governmental Entity’s debt. The City of Memphis Finance Division is in compliance with the State of Tennessee required course: *Tennessee Education Swap Presentation.*

**Goals and Objectives**
The City from time to time would like to take advantage of near historic low interest rates for both new money and refinancing issues using Derivatives. Derivatives, as their name implies, are contracts that are derived from some underlying asset, reference rate or index, including:

- Interest rates
- Foreign exchange rates
- Other fixed income instruments
- Commodities
- Equity indices

Four most common financial derivatives are swaps, forwards, futures, and options

**Interest Rate Swaps**
An interest rate swap is a contractual agreement entered into between two counter-parties under which each agrees to make periodic payment to the other for an agreed period of time based upon a notional amount of principal. The principal amount is notional because there is no need to exchange actual amounts of principal in a single currency transaction. Equally, however, a notional amount of principal is required in order to compute the actual cash amounts that will be periodically exchanged. Under the commonest form of

interest rate swap, a series of payments calculated by applying a fixed rate of interest to notional principal amount is exchanged for a stream of payments similarly calculated but using a floating rate of interest. This is a fixed-to-floating interest rate swap. Alternatively, both series of cash flows to be exchanged could be calculated using floating rates of interest but floating rates that are based upon different underlying indices. Examples might be London Interbank Offer Rate (LIBOR) and commercial paper or Treasury Bills and (LIBOR), this form of interest rate swap is known as a basis or money market swap. LIBOR is the interest rate banks charge each other on short-term money in England's Eurodollar market.

In the municipal market, issuers are increasingly using interest rate swaps, with other derivatives, as part of their debt strategy and asset-liability management. In general, Moody's believes that the prudent use of derivatives – including interest rate swaps – can be an effective tool in meeting funding needs and managing a balance sheet while limiting risk. Swaps and other interest rate derivatives should be used for legitimate, non-speculative purposes.

**Forms of Swap Agreements**

Each new Swap Agreement shall contain terms and conditions as set forth in the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement, as amended, and such other terms and conditions including schedules and confirmations as deemed necessary by an authorized Representative.

**Purpose and Approach**

*Rationale for Utilizing Interest Rate Swaps and Options*

1. Optimize capital structure; including schedule of debt service payments and/or fixed vs. variable rate applications
2. Achieve appropriate asset/liability match.
3. Reduce risk, including
   - Interest rate risk
   - Tax risk
   - Liquidity renewal risk
4. Provide greater financial flexibility
5. Generate interest rate savings
6. Enhance investment yields

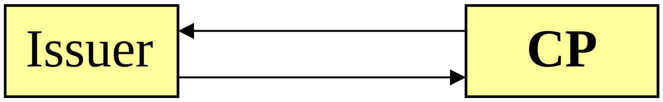
   Manage exposure to changing markets in advance of anticipated bond issuances (throughout the use of anticipatory hedging instruments)

**Objectives**

The City may choose to issue Swaps as a source of interim construction financing for projects contained in the City's approved Capital Improvement Plan only after the Deputy Director of Finance, in consultation with the Financial Advisor, determines that such a financing represents the least cost interim financing option for the City.

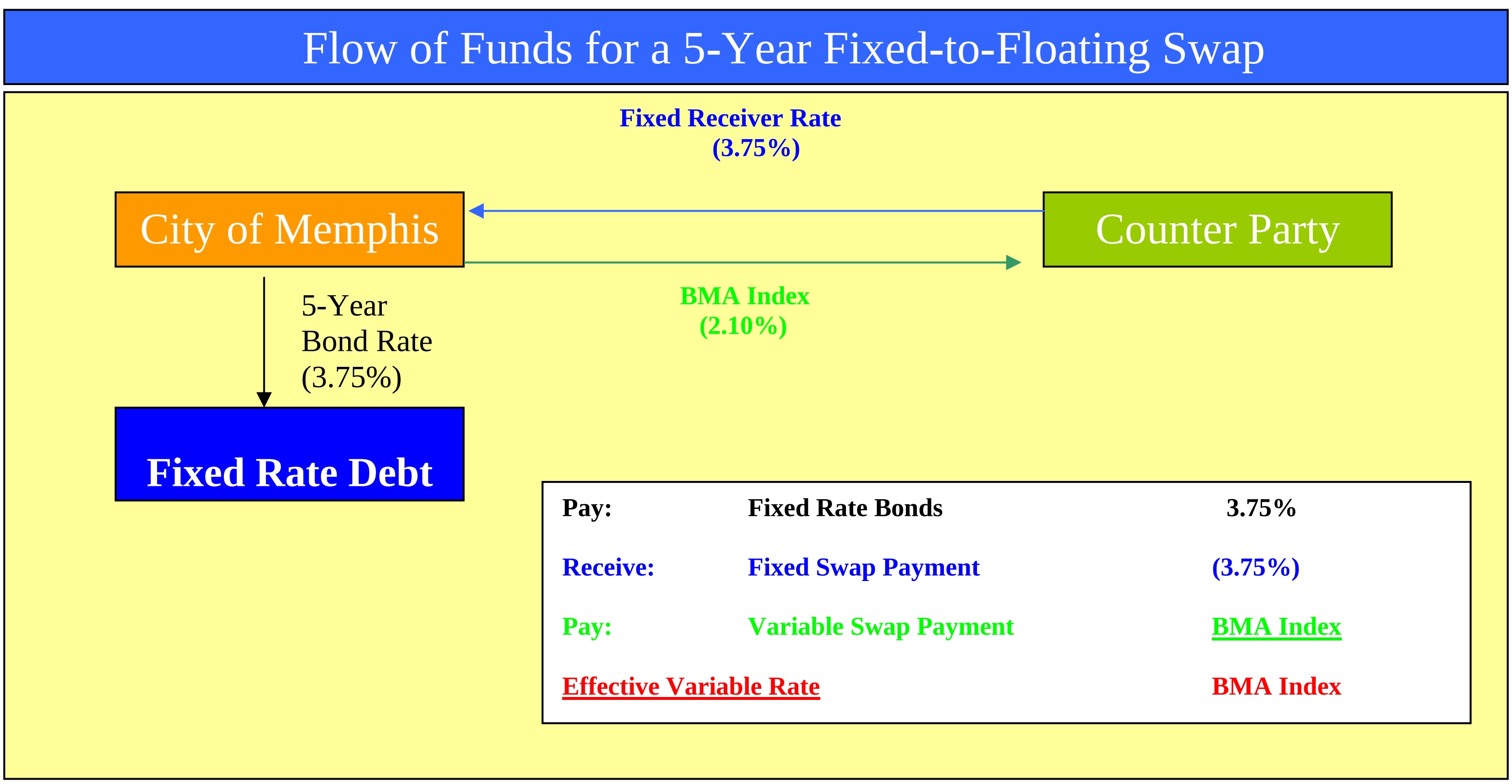
**Example: Fixed to Floating**

- The Counterparty  ("CP") and the Issuer agree that:
  - CP will pay a fixed rate for 5 years on $100,000,000 to the issuer
  - Issuer will pay a variable rate for 5 years on $100,000,000 to CP




- The $100,000,000 is never exchanged and is called the "Notional Amount"
- The variable index can take a variety of forms including:
  - **LIBOR –** London Interbank Offering Rate (the rate at which international banks lend to each other) denominated in U.S. dollars (Taxable).
  - **BMA Index –** The Bond Market Association Municipal Swap Index (formerly known as The PSA Municipal Swap Index) (Tax-Exempt).

**The City of Memphis can use a fixed-to-floating swap to create synthetic variable rate debt.**




| | | |
|---|---|---|
| **Pay:** | **Fixed Rate Bonds** | **3.75%** |
| **Receive:** | **Fixed Swap Payment** | **(3.75%)** |
| **Pay:** | **Variable Swap Payment** | **BMA Index** |
| **Effective Variable Rate** | | **BMA Index** |

**Swap Management Considerations**

The City will seek to maximize the benefits and minimize the risks it carries by actively managing its swap program. This will entail frequent monitoring of market conditions, by both the Financial Advisor and swap counter party, for emergent opportunities and risks. Active management may require modifications of existing positions including, for example:

1. Termination Provisions
2. Shortening or lengthening the term
3. Sale or purchase of options
4. Use of basis swaps
5. Counterparty Credit Risks
6. Collateral
7. Hedging
8. Debt Service Savings

# *CREDIT RATINGS AND ENHANCEMENTS POLICY*

The City of Memphis will seek a rating from a least one of the nationally recognized bond rating agencies on all new issues that are being sold in the public market.

**A. <u>Rating Agency Relationships.</u>** The Debt Management and Finance Administration Offices are responsible for maintaining relationships with the rating agencies that currently assign ratings to the City's various debt obligations. This effort shall include providing periodic updates on the City's general financial condition along with coordinating meetings and presentations in conjunction with debt issuances.

As part of the rating process, it is often useful and sometimes required to hold meetings with representatives of credit rating agencies. Meetings can be either at the rating agency's offices or in Memphis. Such meetings give the City an opportunity to make a presentation, provide a framework for resolution of questions, and facilitate and exchange of views. Rating agencies concentrate on, but are not limited to these four key analytical factors:

- Economic Environment of City
- Debt Structure
- Administrative, Legislative and Political Climate
- Fiscal Management

**B. <u>Use of Rating Agencies.</u>** The Deputy Director of Finance shall be responsible for determining whether or not a rating shall be requested on a particular financing, and which of the major rating agencies shall be asked to provide such a rating.

**C. <u>Minimum Long-Term Rating Requirements.</u>** The City shall strive to maintain a rating of at least "AA" on its General Obligation Debt.

A lower rating standard may be accepted for indirect or conduit obligations, subject to review by the Deputy Director of Finance and approval of the Finance Director.

**D. <u>Use of Credit Enhancement.</u>** The City shall seek to use credit enhancement (letters of credit, bond insurance, surety bonds, etc.) when such credit enhancement proves cost-effective. Selection of credit enhancement providers shall be subject to a competitive bid process developed by the Deputy Director of Finance and/or Financial Advisor. Credit enhancement may be used to improve or establish a credit rating on a City debt obligation even if such credit enhancement is not cost effective if, in the opinion of the Deputy Director of Finance, the use of such credit enhancement meets the City's debt financing goals and objectives.

The City will consider the use of credit enhancement on a case-by-case basis, evaluating the economic benefit versus cost for each case. Only when a clearly demonstrable savings can be shown shall enhancement be considered. The City will consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancement.

1. *Bond Insurance*. The City shall have the authority to purchase bond insurance when such purchase is deemed prudent and advantageous. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds.

2. *Debt Service Reserve Funds*. When required, a reserve fund may be used to strengthen the underlying credit of the debt.

   The City’s Debt Service Fund (DSF) should maintain an undesignated fund balance equal to or greater then 1/12 or 8% of DSF expenditures.

## *REFUNDING OF CITY INDEBTEDNESS POLICY*

The City may issue current refunding bonds (as defined for federal tax law purposes) when economically advantageous, legally permissible, prudent, and a target of 3.50% in net present value savings of original issue is achieved or in excess of $1 million net dollar savings.

**A.** **<u>Debt Service Savings - Bond Refunding.</u>** The Deputy Director of Finance along with the City's Financial Advisor(s) have the responsibility to analyze outstanding bond issues for refunding opportunities that may be presented by underwriting and/or financial advisory firms. The City will, during periods of lowering interest rates, take advantage of the rate changes by refunding previously issued bonds. Usually, this will be in the form of an advance refunding of callable bonds.

**B.** **<u>Debt Service - Advance Refunding</u>.** The City may choose to refund outstanding indebtedness when existing bond covenants or other financial structures impinge on prudent and sound financial or operational management. Savings requirements for advance refunding undertaken to restructure debt may be waived by the Deputy Director of Finance and the Finance Director upon a finding that such a restructuring is in the City's overall best financial, organizational or operational interests.

An advance refunding is an important debt management tool for state and local government issuers. It is commonly used to achieve interest cost savings, remove or change burdensome bond covenants, or restructure the stream of debt service payments to avoid a default, or in extreme circumstances, an unacceptable tax or rate increase. Advance refunding which is limited in number by federal tax law must be carefully planned and undertaken to be successful.

**C.** **<u>Open Market Purchase of Securities.</u>** The City may choose to defease its outstanding indebtedness through purchases of securities on the open market when market conditions make such an option financially feasible. The Deputy Director of Finance and the Financial Advisor shall be responsible for developing procedures for executing open market purchases and the savings objectives to be achieved by undertaking such action.

## *MARKET AND INTER-AGENCY RELATIONSHIPS POLICY*

The City of Memphis Director of Finance & Deputy Director of Finance and Financial Advisor will provide the rating agencies that maintain a rating on City securities with available material that has a pertinent bearing on City Finances.

**A.** **Rating Agencies and Investors.** The Deputy Director of Finance, Finance Director and Financial Advisor shall be responsible for maintaining the City's relationships with Moody's Investors Service, Standard & Poor's and Fitch. The City may, from time-to-time, choose to deal with only one or two of these agencies as circumstances dictate. In addition to general communication, the City's Finance Team shall (1) meet with credit analysts at least once each fiscal year, and (2) prior to each competitive or negotiated sale, offer conference calls with agency analysts in connection with the sale.

**B.** **Continuing Disclosure.** The City shall remain in compliance with Rule 15c2-12 by Filing its annual financial statements and other financial and operating data for the benefit of its bondholders within 240 days of the close of the fiscal year. The inability to make timely filings must be disclosed and is a negative reflection. While there is reliance on timely audit and preparation of the City's annual report, the Comptroller will ensure that the City's timely filing with each Nationally Recognized Municipal Securities Information Repository and State Repository.

**C.** **Rebate Reporting.** Existing regulations require arbitrage to be rebated every five years. However, the City assesses their arbitrage liability for each issue on an annual basis. Therefore, the Deputy Director of Finance shall ensure that proceeds and investments are tracked in a manner, which facilitates accurate calculation that calculations are completed, and rebates, if any, made in a timely manner.

**D.** **Other Jurisdictions.** From time to time, the City will issue bonds on behalf of other Public or private entities. While the City makes every effort to facilitate the desires of these entities, the Director of Finance and the Deputy Director of Finance will ensure that the highest quality financings are done and that the City is insulated from all risks.

**E.** **Fees.** The City will charge an administrative fee equal to direct costs to reimburse its Administrative costs incurred in debt issuance on behalf of other governmental entities.

1. It is herby determined that there shall be issued and there are hereby authorized to be issued general obligation bonds of the City of Memphis. Tennessee in the maximum principal amount of not to exceed One Hundred Seventy-Five Million Dollars ($175,000,000.), pursuant to the Local Government Public Obligations Acts of 1986, being Title 9, Chapter 21, of the Tennessee Code Annotated, for the purpose financing the cost of the following public works projects:

Abattoirs, acquisitions of land for the purpose of providing or preserving open land, airports, alleys, ambulances, auditoriums, bridges, city halls, City stables or garages, community houses, corrective, detention and penal facilities, including but not limited to, jails, workhouses and reformatories, courthouses, culverts, curbs, dispensaries, drainage systems, including storm water sewers and drain, electric plants and systems, expositions, facilities for the handicapped, including physically and mentally handicapped, facilities for the indigent, fairgrounds and fairground facilities, fire department equipment and building, fire alarm systems, flood control, garbage collection and disposal systems, gas and natural gas systems and storage facilities, heat plants, and systems, harbor and riverfront improvements, health centers and clinics, including medical and mental health centers and clinics, highways, major roads, highway and street equipment, hospitals, hotels and supporting or incidental facilities built adjacent to and as a supporting facility of civic or convention centers located in the central business improvement district of the City created under the provisions of the Central Business Improvement District Act of 1971, title 7, chapter 84, improvements made pursuant to a plan of improvement for a central business improvement district created pursuant to the Central Business District Act of 1971, title 7, chapter 84, incinerators, law enforcement and emergency services equipment, levees, libraries, markets, memorials, museums, nursing homes, parks, parking facilities, parkways, playgrounds, plazas, port facilities, docks and facilities, including ant terminal storage and transportation facilities incident thereto, public art, public buildings, preserves, railroads, including railway beltlines and switches, reclamation of land, recreation centers and facilities, reservoirs, rights-of-way, river and navigation improvements, roads, sanitariums, schools, transportation equipment for schools, sewers, sewerage and waste water systems, including, but not limited to, collection, drainage, treatment and disposal systems, ship canals, sidewalks, stadiums, streets, swimming pools, thermal transfer generating plants and/or distribution systems, tunnel, viaducts, voting machines, water treatment distribution and storage systems, wharves, zoos, business parks, industrial parks, urban renewal projects, urban transit facilities, facilities for the storage and industrial parks, urban renewal projects, urban transit facilities, facilities for the storage and maintenance of any of the items of equipment which constitute public works projects and all property real and personal, appurtenant thereto or connected with such work, undertaking or project, and the existing work, undertaking or project, if any, to which such work, undertaking or project is an extension, addition, betterment or improvement.

# The Sanitary Sewerage System

The City of Memphis has been providing sewer collection and treatment services to residents and businesses since 1878. The present Sewerage System includes the City, Shelby County, and a hybrid of incorporated areas with which the City maintains operating agreements.

The Sewerage System includes:

- 3,600 miles of sewer mains;
- 90 pumping stations; and
- The T. E. Maxson and M. C. Stiles Wastewater Treatment Plants

The primary objectives of the System are:

1. To support the quality of life and economic growth in the System's service area; and
2. To meet the stringent environmental standards for the protection of the service area in an economically sound manner.

# The Sanitary Sewerage System

**The T. E. Maxson Wastewater Treatment Plant**

- Current facility built in 1975
- Discharges into the Mississippi River
- Continuously upgraded since 1981
- Capacity of 90 million gallons a day (“mgd”)
- Currently processes an average 72 mgd
- Use of end products (primary and secondary waste sludge):
  - Sludge: anaerobically digested, then dewatered and land applied to 650 acre adjacent plant site
- $12 million dollar upgrade of the covered lagoons at the City’s T. E. Maxson Wastewater Treatment Facility has been completed. This upgrade provides additional anaerobic digestion capacity and has resulted in substantially increased volumes of biogas. The biogas is pumped to the TVA coal fired Allen Steam Plant and is used as a fuel source to generate electricity.

# The Sanitary Sewerage System

**The M. C. Stiles Wastewater Treatment Plant**

- Current facility built in 1977
- Discharges into the Mississippi River
- Capacity of 135 million gallons a day ("mgd")
- Currently processes an average 88 mgd
- Use of end products (secondary waste sludge only):
    - Sludge: anaerobically digested, then dewatered to a 18% dry solid cake, dried to 50% solids using a drying bed approach, and then placed in an on- site sludge only landfill.
- The construction of two sludge lagoon covers at a cost of $5 million will be completed at the City's M.C. Stiles Wastewater Treatment Facility during the 2005 and 2006 fiscal years.

# The Sanitary Sewerage System

## Residential Rates and Charges

*The System currently collects two charges : **Service Charge** and **Additional Treatment Surcharge**. Service Charges are collected periodically for actual usage of the wastewater system.*

| Fiscal Year | Volumetric Charge Per 100 Cubic Feet (Monthly) | | Additional Treatment Cost (Sewer Surcharge) | |
|---|---|---|---|---|
| | Dollars per 100 cu. ft. | Maximum Residential Charge | Dollars per pound of BOD | Dollars per pound of suspended solids |
| Second half of FY1982 to FY2005 | $0.44 | $12.00 | $0.027 | $0.046 |
| Rates effective beginning July 1, 2004 (1) | $0.65 | $18.00 | $0.036 | $0.059 |

*(1) Sewer Fee increase will be implemented in phases over a 2-year period for industrial customers.*

## CAPITAL IMPROVEMENT BUDGET
***(Thousands of Dollars)***

| Description | FY06 | FY07 | FY08 | FY09 | FY10 |
|---|---|---|---|---|---|
| Rehabilitation of Existing Sewers (a) | $5,770 | $5,920 | $6,000 | $6,100 | $6,100 |
| Service to Unsewered Areas (a) | 200 | 200 | 200 | 200 | 200 |
| Misc. Subdivision Outfall Construction (b) | 1,800 | 1,800 | 1,800 | 1,800 | 1,800 |
| Sludge Disposal Earth Complex (a) | 500 | 500 | 500 | 500 | 500 |
| Wolf River Grays Creek Improvements (a) | 8,000 | 8,000 | 8,000 | 4,000 | 4,000 |
| Loosahatchie Interceptor (a) | 2,000 | 0 | 0 | 0 | 0 |
| South Plant Expansion (a) | 6,000 | 6,000 | 2,000 | 4,000 | 4,000 |
| Environmental Maintenance Relocation | 1,000 | 3,000 | 0 | 0 | 0 |
| Marys Creek Interceptor(a) | 1,600 | 2,900 | 0 | 0 | 0 |
| Total(c) | $26,870 | $28,320 | $18,500 | $16,600 | $16,600 |

Source: Division of Public Works

(a) All locally funded.
(b) Funded 50% by developer through up-front extension fees and the balance is funded by development fees.
(c) The amounts shown will be capitalized in the Sewer Fund.

# The Sanitary Sewerage System Management Practices

## SEWER ADMINISTRATION AND OPERATIONS

- Operated efficiently with one of the lowest rate bases among its peers.
- Long-term financial forecasting through its Capital Budget and Capital Improvement Program.
- Effective collection policies through Memphis Light, Gas & Water ("MLGW").
- *Will maintain a cash balance of at least $15 million dollars and debt service coverage of 1.25x as required by Resolution to support debt payments.
- Experienced management with over 25+ years

**Cash balance includes unreserved, renewal & replacement and reserve fund.*

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## *GLOSSARY*

**Advance Bonds Refunding:** The sale of new municipal bonds in advance, usually by several years, of the first call date of the old bonds. The refunding issue has a lower rate than the issue to be refunded, and proceeds are invested, traditionally in government securities, until the higher rate bonds become callable.

**Arbitrage:** The difference between the interest paid on the tax-exempt securities and the interest earned by investing the security proceeds in higher-yielding taxable securities. IRS regulations govern arbitrage on the proceeds from issuance of municipal securities.

**Bond:** The written evidence of debt, bearing a stated rate or stated rates of interest, or long-term securities with a maturity of greater than one year.

**Call Provisions:** The terms of the bond contract giving the issuer the right to redeem all or a portion of an outstanding issue of bonds prior to their stated dates of maturity at a specific price, usually at or above par.

**Capitalized Interest:** A portion of the proceeds of an issue, which is set aside to pay interest on the securities for a specific period of time. Interest is commonly capitalized for the construction period of the project.

**Certificates of Participation (COP):** A bond from an issue, which is secured by lease payments made by the party leasing the facilities, financed by the issue. Typically certificates of participation ("COPs") are used to finance construction of facilities (i.e., schools of office buildings) used by a state or municipality, which leases the facilities from a financing authority. Often the leasing municipality is legally obligated to appropriate moneys from its general tax revenues to make lease payments.

**Commercial Paper:** Very short-term, unsecured promissory notes issued in either registered or bearer from, and usually backed by a line of credit with a bank.

**Competitive Sale:** A sale of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities in contrast to a negotiated sale.

**Continuing Disclosure:** The principle that accurate and complete information material to the transaction which potential investors would be likely to consider material in making investment decisions with respect to the securities be made available on an ongoing basis.

**Credit Enhancement:** Credit support purchased by the issuer to raise the credit rating of the issue. The most common credit enhancements consist of bond insurance, direct or standby letters of credit, and lines of credit.

**Debt Service Reserve Fund:** The fund in which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements.

**Deep Discount Bonds:** Bonds that are priced for sale at a substantial discount from their face or par value.

**Derivatives:** A financial product whose value is derived from some underlying asset value. An interest rate swap is a contract between two parties to exchange cash flows over a pre-determined length of time.

**Designation Policies:** Outline how an investor's order is filled when maturity is oversubscribed when there is an underwriting syndicate. The senior managing underwriter and issuer decide how the bonds will be allocated among the syndicate. There are three primary classifications of orders, which form the designation policy.

The highest priority is given to Group Net orders; the next priority is given to Net Designated orders and Member orders are given the lowest priority.

**Escrow:** A fund established to hold moneys pledged and to be used to pay debt service on an outstanding issue.

**Expenses:** Compensates senior managers for out-of pocket expenses including: underwriters counsel, DTC charges, travel, syndicate expenses, dealer fees, overtime expenses, communication expenses, computer time and postage.

**General Obligations (GO):** Long-term borrowings that are backed by the full faith, credit, and taxing powers of the issuing locality rather than income generated by a specific operation or service.

**Lease-Purchase:** A financing lease which may be sold publicly to finance capital equipment, real property acquisition or construction. The lease may be resold as certificates of participation or lease revenue bonds.

**Letters of Credit:** A bank credit facility wherein the bank agrees to lend a specified amount of funds for a limited term.

**Management Fee:** The fixed percentage of the gross spread which is paid to the managing underwriter for the structuring phase of a transaction.

**Members:** Underwriters in a syndicate other than the senior underwriter.

**Moody's Median:** Key financial, debt, economic and tax base statistics with median values for each statistic presented. Moody's uses audits for both rated and unrated cities to ensure that the medians presented are representative of all cities.

**Negotiated Sale:** A method of sale in which the issuer chooses one underwriter to negotiate terms pursuant to which such underwriter will purchase and market the bonds.

**Original Issue Discount:** The amount by which the original par amount of an issue exceeds its public offering price at the time it is originally offered to an investor.

**Overlapping Debt:** That portion of the debt of other governmental units for which residents of a particular municipality are responsible.

**Pay-As-You-Go:** An issuer elects to finance a portion of its capital plan with existing cash flows.

**Present Value:** The current value of a future cash flow.

**Private Placement:** The original placement of an issue with one or more investors as opposed to being publicly offered or sold.

**Rebate:** A requirement imposed by Tax Reform Act of 1986 whereby the issuer of the bonds must pay the IRS an amount equal to its profit earned from investment of bond proceeds at a yield above the bond yield calculated pursuant to the IRS code together with all income earned on the accumulated profit pending payment.

**Refunding:** Replacing an old bond issue with a new issue, either before or at maturity of the older one. It is often done to change the interest rate on the debt.

**Selling Groups:** The group of securities dealers who participate in an offering not as underwriters but rather who receive securities less the selling concession from the managing underwriter for distribution at the public offering price.

**Swaps:** Interest rate swaps are a contractual agreement entered into between two counter-parties under which each agrees to make periodic payment to the other for an agreed period of time based upon a notional amount of principal.

**Syndicate Policies:** The contractual obligations placed on the underwriting group relating to distribution, price limitations and market transactions.

**Tax Increment:** A portion of property tax revenue received by a redevelopment agency, which is attributable to the increase in assessed valuation since adoption of the project area plan.

**Underwriter:** A dealer that purchases new issues of municipal securities from the issuer and resells them to investors.

**Underwriter's Discount:** The difference between the price at which bonds are bought by the Underwriter from the Issuer, and the price at which they are reoffered to investors.

**Variable Rate Debt:** An interest rate on a security, which changes at intervals according to an index or a formula or other standard of measurement as, stated in the bond contract.

# GLOSSARY OF TERMS FOR DERIVATIVES

**Asset/Liability Matching:** Matching the term and amount of assets and liabilities in order to mitigate the impact of changes in interest rates.

**Bid/Ask Spread:** The difference between the bid price (at which a market maker is willing to buy) and the ask price (at which a market maker is willing to sell).

**BMA:** Bond Market Association

**BMA Municipal swap index:** An average of over 200 active, high-grade, tax-exempt, variable rate programs with weekly interest rate resets.

**Call Option:** The right to buy an underlying asset (e.g. a municipal bond) after a certain date and at a certain price. A call option is frequently embedded in a municipal bond, giving the issuer the right to buy, or redeem, the bonds at a certain price.

**Collateral:** Assets pledged to secure an obligation. The assets are potentially subject to seizure in the event of default.

**Counterparty:** One of two entities in a traditional interest rate swap. In the municipal market, counterparty and a party can be a state or local government, a broker-dealer or a corporation.

**Downgrade:** A negative change in credit ratings.

**Forward Starting Rate Swap:** Interest rate swaps that start at some time in the future. Used to lock-in current interest rates.

**Hedge:** A transaction that reduces the interest rate of an underlying security.

**Interest Rate Swap:** The exchange of a fixed interest rate and a floating interest rate between counterparties.

**Liquidity Support:** An agreement by a bank to make payment on a variable rate security to assure investors that the security can be sold.

**LIBOR:** The London Interbank Offer Rate. Used as an index to compute the variable rate on an interest rate swap.

**Notional Amount:** The amount used to determine the interest payments on a swap.

**Termination Payment:** A payment made by counterparty is required to terminate the swap. The payment is commonly based on the market value of the swap, which is computed using the rate on the initial swap and the rate on a replacement swap.

# *Bond Rating Definitions*

| Moody's Investors Service | Standard & Poor's Corporation | Fitch IBCA | Definitions |
|---|---|---|---|
| Aaa | AAA | AAA | Prime. Maximum Safety. |
| Aa1 | AA+ | AA+ | High Grade. High Quality. |
| Aa2 | AA | AA | |
| AA3 | AA- | AA- | |
| A1 | A+ | A+ | Upper Medium Grade. |
| A2 | A | A | |
| A3 | A- | A- | |
| Baa1 | BBB+ | BBB+ | Lower Medium Grade. |
| Baa2 | BBB | BBB | |
| Baa3 | BBB- | BBB- | |
| Ba1 | BB+ | BB+ | Non-investment Grade. |
| Ba2 | BB | BB | Speculative. |
| Ba3 | BB- | BB- | |
| B1 | B+ | B+ | Highly Speculative. |
| B2 | B | B | |
| B3 | B- | B- | |
| Caa | CCC+ | CCC | Substantial Risk |
| | CCC | | In Poor Standing |
| | CCC- | | |
| Ca | | | Extremely Speculative. |
| C | | | May Be in Default. |
| | | DDD | Default. |
| | | DD | |
| | D | D | |

# MOODY'S DEFINITION OF RATINGS

**Aaa**
Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged." Interest payments are protected by a large or by the exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

**Aa**
Bonds which are related Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there mat be other elements present which make the long—term risk appear somewhat larger than the Aaa securities.

**A**
Bonds which are rated A possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. Factors giving security principal and interest are considered adequate, but the elements may be present which may suggest a susceptibility to impairment sometime in the future.

**Baa**
Bonds which are rated Baa are considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

**Ba**
Bonds which are rated Ba are judged to have speculative elements, their future cannot be considered as well assured. Often the protection of interest and principal payments may be very moderate and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

**B**
Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of investment and principal payments or of maintenance or other terms of the contract over any long period of time may be small.

**Caa**
Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

**Ca**
Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

**C**
Bonds which are rated C are the lowest rated class of bonds, and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

# *REFERENCES*

In the development of this Debt Management Policy substantial contribution was provided by or obtained from the following references and/or sources:

City of Memphis:

Mayor
City Council
Chief Administrative Officer
Finance Division

Fitch IBCA

Government Finance Officers Association (GFOA)

International Monetary Fund (IMF)

Moody’s Investor Service

Public Financial Management (PFM)

Standard & Poor’s Corporation (S & P)

Morgan Keegan

Goldman Sachs